Zenith Investment Partners

Highly Recommended
Recommended
Approved
Not Rated
Redeem

Product Assessment

Qualitas Real Estate Income Fund

Report data as at 30 Apr 2020
Rating issued on 02 Jun 2020

VIEWPOINT

The Qualitas Real Estate Income Fund (the Trust) is a Listed Investment Trust (LIT) managed by the Qualitas Group (Qualitas). Qualitas is a specialist real estate investment management firm with offices in Sydney and Melbourne, focussed on investing across the credit quality spectrum. The Trust seeks to provide a targeted return of 8.0% p.a., via exposure to secured real estate loans. Zenith believes the diversifying properties of the underlying asset class, coupled with Qualitas' strong investment team, and rigorous process, positions the Trust to deliver potentially attractive risk adjusted returns. Our view is however tempered by the relatively recent formation of the Trust and an uncompetitive fee structure.

Formed in 2008, Qualitas operates an integrated business where loan origination, asset due diligence, financial due diligence and credit risk are undertaken internally. Qualitas utilises multiple committees and boards to maintain oversight over operations and investment policies. Zenith believes that the level of depth and expertise held across the various committees and boards, is significant and a key strength of the business. Zenith believes that the high levels of independent representation on the majority of these groups act as a strong risk control.

Listed on the ASX in November 2018, the Trust's portfolio gains exposure to private credit via its investment in the Qualitas Wholesale Real Estate Income Fund (Sub-Fund). The Sub-Fund takes indirect or direct exposure to secured real estate loans by investing in and alongside other Qualitas funds. The Sub-Fund is relatively unconstrained in its ability to invest either indirectly or directly. Indirect exposure is achieved by the Sub-Fund investing as a unitholder in the Qualitas wholesale funds or investing as a noteholder in the Arch Finance Warehouse Trust note program. Direct investments may be made as deemed necessary.

Qualitas adopts a fundamentally driven, bottom-up approach to lending. Target markets are commercial borrowers seeking to finance real estate development, investment, acquisition or value-add projects. Sectors involved are mainly residential (apartments and other multi-dwelling buildings), office, retail and industrial.

Risk parameters such as minimum or maximum limits on diversification, loan covenants and security level vary according to the underlying vehicle exposure. QRI predominantly invests in the funds managed by Qualitas, taking exposure where it is consistent with the Trust's investment objectives. Accordingly, the more traditional type of manager selection process common to traditional multi-manager strategies is not evident in the Trust. Zenith highlights that the allocation to underlying funds/mandates is largely subjective, albeit consistent with the Trust achieving diversification across borrower, real estate segment and being reflective of market activity. Each of the underlying strategies to which the Trust is exposed is positioned at different points of the risk continuum with different return objectives.

Portfolio construction reflects the top-down views of Qualitas. In setting each portfolio, Qualitas considers each fund's target return, diversification guidelines and issuer limits. In addition, given the limited liquidity of the asset class, Qualitas seeks to diversify across holding periods, tenors to maturity and credit quality.

Investing in loans is a highly specialised skill set that extends well beyond traditional credit investing. For example, investing in real estate loans requires a complete understanding of the origination process, knowledge of funding structures, assessing projects, vetting involved parties and the ability to manage distressed assets. Zenith believes that the Qualitas team are well positioned to meet the Trust's objectives.

FUND FACTS

- LIT seeking to generate a target return of 8.0% p.a. (net of fees)
- Exposure to private credit, focussing on the Australian real estate loan market
- Quality investment team has material real estate lending experience

ABSOLUTE RISK (SECTOR)

- VERY HIGH
- HIGH
- ▶ MODERATE
- LOW
- VERY LOW

RELATIVE RISK (FUND WITHIN SECTOR)

- High Yield
- Investment Grade
- Multi-Sector
- Opportunistic Credit
- ▶ Private Credit

INCOME DISTRIBUTIONS PER

MONTH (selected) | QUARTER | 6 MONTH | ANNUM

INVESTMENT TIMEFRAME

1-2 YRS | 3-4 YRS (selected) | 5-6 YRS | 7+ YRS

APIR Code
ASX:QRI

Asset / Sub-Asset Class
Australian Fixed Interest
Listed Investment Entities – LICs/LITs

Investment Style
Active

Investment Objective
To achieve an annual target return 8.0% (net of fees and expenses), provide monthly cash income, capital preservation and portfolio diversification.

Zenith Assigned Benchmark
Bloomberg AusBond Bank Bill Index
QRI Net Portfolio Returns

Net Returns (% p.a.)

	1 yr	6 mth	3 mth
LIC	-12.36	-10.20	-12.48
Benchmark	1.12	0.46	0.22

Fees (% p.a., Incl. GST)
Management Cost: 1.95%
Performance Fee: 20% profit share triggered over a 8.0% p.a. return hurdle

APPLICATIONS OF INVESTMENT

SECTOR CHARACTERISTICS

Listed Investment Trusts (LITs)

In assessing the performance of LITs, it is vital to understand how their structure affects the final performance figures as it is materially different to unlisted funds. As listed vehicles, the portfolio returns generated are exposed to additional volatility from unit price movements and can trade at significant premiums or discounts to Net Asset Value (NAV).

As an indication however, a series of return data can be viewed on the basis of the returns generated by:

- Unit price and distributions
- Change in NAV and distributions
- Returns generated internally by the investment portfolio

For comparison purposes, the use of the internal portfolio returns versus the benchmark gives the closest measure of the investment manager's skill in generating returns. However, these returns may not be able to be fully crystallised for holders given the potential for unit price movements on the ASX.

At various times when assessed on a purely quantitative basis, a LIT can trade away from its NAV which may represent good buying or selling opportunities. While these instances may boost investment returns, there is no guarantee that the discount or premium will converge to NAV, therefore, gains may not be crystallised.

LITs differ in several important ways from Listed Investment Companies (LICs). Of particular note, owing to the trust structure used by LITs, 100% of net trust income must be paid as a distribution in the year it is earned. As a company, LIC's will pay dividends at the election of the Board in accordance with the LIC's dividend policy. LIC profits may be retained in order to create a more even flow of dividends.

Australian Fixed Interest

The sector typically comprises funds investing in the Australian fixed interest market, specifically focusing on the corporate debt market. The sector incorporates both benchmark aware and unaware strategies. Managers typically add value through sector positioning and security selection.

Zenith benchmarks all funds in this space against the Bloomberg AusBond Bank Bill Index, which is reflective of the underlying benchmark used by the majority of managers in this category. Given funds in the sector typically invest in longer dated corporate securities they may display greater downside volatility than the Index, i.e. while the index is used as a performance benchmark it’s not representative of the risks involved in investing in the corporate debt sector.

Demand for higher yielding corporate issues (including loans) has risen in more recent times owing to the co-ordinated effort by central authorities to maintain historically low cash rates. This has increased investor tolerance for lower-grade and higher yielding debt to enhance income generation.

PORTFOLIO APPLICATIONS

Private credit typically refers to direct lending operations that are generally made to sub-investment grade companies or projects and are therefore expected to generate a yield pick up above investment grade bonds. However, investors should be aware that the Trust may not provide the defensive characteristics of traditional bonds and returns may be correlated with those of broader equity markets in periods of stress.

Zenith believes the Trust may be suitable for investors seeking exposure to a higher yielding portfolio which may improve a portfolio's potential risk/return profile. However, given the nature of the asset class this may be less suitable for the more risk adverse investor. From a portfolio perspective, the Trust may be suitable as a component of a well-diversified portfolio. The Trust is considered appropriate as a satellite exposure.

Notwithstanding the quality aspects of Qualitas' lending process, there is potential for moderate to high levels of volatility, with the potential for capital loss. As such, Zenith recommends taking a medium to long-term investment time frame.

Despite the relative merit of a strategy, investors should give consideration to the method of access. While the unlisted fund structure may be less convenient for some investors, accessing a strategy via a LIT will mean that the effectiveness of the strategy may be significantly diminished due to the Trust's own trading movements. That is, investors may not be able to benefit from the portfolio's performance, as the performance of the Trust is driven by market sentiment.

One of the benefits of the LIT structure is that the Trust, unlike in an unlisted managed fund, does not have to sell holdings to fund redemptions. Zenith believes this feature is a key advantage for the Trust given its bias toward less liquid assets.

RISKS OF THE INVESTMENT

SECTOR RISKS

Funds within the Australian Fixed Interest – Listed Investment Entities sector are exposed to the following broad risks:

MARKET RISK: Changes in economic, technological, environmental or political conditions and market sentiment may lead to a decline in general security prices and overall market volatility. During a general downturn in the securities markets, multiple asset classes may decline in value simultaneously.

CREDIT SPREAD RISK: In addition to being sensitive to general interest rate changes, non-government securities are also sensitive to changes in credit spreads (commonly the difference in yield between a government bond and a corporate security). A widening of spreads results in a fall in the value of these securities.

DEFAULT RISK: Given fixed interest securities represent loans to borrowers (including governments, banks and companies) there is a risk that these borrowers may default on interest or principal repayments. Default risk is often reflected in credit ratings assigned by various credit agencies, which are subject to change.

LIQUIDITY RISK: Fixed interest markets can experience periods of illiquidity, which can result in difficulties in buying or selling securities without adversely impacting the price.

CREDIT RISK: Loans to borrowers involve risk that these borrowers may default on interest or principal repayments. Credit risk is often reflected in credit ratings assigned by various credit agencies, which are subject to change.

INTEREST RATE RISK: May be derived from a number of sources including market interest rate movements, prepayment risk and overweighting to low yielding assets.

CAPITAL RISK: Occurs when loans default and the realisation of the security asset is insufficient to repay the debt.

PREMIUM / DISCOUNT TO NAV: The listed structure means that a LIC's share price may deviate substantially from its underlying net assets due to cyclical and/or sentiment driven factors. Movements in either premiums or discounts can be unpredictable and may have a significant impact on realisable value and the overall investment returns regardless of the investment managers skill.

REGULATORY RISK: The ASIC Regulatory Guide 97 'Disclosing Fees and Costs in Product Disclosure Statements and Periodic Statements' came into effect on 1 October 2017 and seeks to establish a common framework for disclosing fees with respect to registered managed investment schemes issued to retail investors.

In November 2019, ASIC released its final recommendations, with all proposed changes to be implemented by 30 September 2020.

In its current form, RG97 will not impact the actual costs (or after fee returns) on existing investments. Rather, the guide is focused on providing increased transparency with respect to the costs of management. Given this, it is feasible that under RG97, investors become more sensitive to the costs charged and seek lower cost alternatives, potentially leading to fund outflows.

FUND RISKS

Zenith has identified the following key risks of the Trust. Although Zenith believes the risks noted are all significant, we have listed them in order of importance. In addition, we have not intended to highlight all possible risks.

ASSET CLASS RISK: Although the Trust offers some diversity in terms of regions, sectors, borrowers and loan maturities, the portfolio is exposed to the performance of the real estate credit market, particularly residential development. As such, a key risk to the performance of the Fund is a significant deterioration in this market, which could eventuate due to an economic shock or a general deterioration in the economic and credit environment.

LOAN VALUATION RISK: Given the idiosyncratic nature of loans investing coupled with the limited secondary market, valuation risk is considered high for the Trust. While Qualitas has a clearly defined valuation policy, there is a risk that the realisable value of securities may not align with the mark-to-market value carried by Qualitas.

FUND LIQUIDITY RISK: The Trust can invest into unlisted funds dealing in illiquid assets. Any impediment in liquidity in these underlying funds may limit the ability of the Trust to effectively allocate capital in a timely fashion.

SUBORDINATED CREDIT RISK: The Trust may have exposure to securitised debt investments. These structures typically involve investment in various tranches of notes in a warehouse facility. The class structure of the notes establishes a priority of payment (waterfall) for interest and principal. As a result, the waterfall structure means that in the event of any losses, higher ranking securities will be prioritised over lower tranches. Even where the underlying assets may be relatively low risk, subordinated tranches may have materially elevated risk profiles.

MARGIN COMPRESSION: Compression of interest rate margins can pose material risks to achievable interest rates from loan portfolios. These risks can be compounded in subordinated credit structures such as investment in notes issued via a warehouse facility. If margins fall below a certain level, low ranking tranches of notes may be prevented from receiving any income owing to waterfall structures.

LEVERAGE RISK: Short-term financing may be used by both the Trust and underlying investment vehicles to manage lending commitments and ultimately achieve their investment objectives. This may magnify gains and losses on underlying holdings.

KEY PERSON RISK: Given the committee based decision-making structure, Zenith considers key person risk to be low. Notwithstanding this, if any of the key individuals listed in the report were to depart, this would warrant a reassessment of our rating.

SUB-INVESTMENT GRADE CREDIT RISK: By its nature and as reflected by its rating, sub-investment grade debt has a higher potential of default. Although investors have historically been compensated in the form of excess returns, there is the potential for the strategy to experience more defaults than the broader market.

Additionally, defaults tend to cluster in certain years and therefore investors should expect periodic episodes of higher defaults. Nevertheless, given the Trust is expected to have a significant proportion of the portfolio in sub-investment grade debt, investors should be aware of the increased risk involved in this allocation. That said, given the senior secured nature of the majority of loans, they have traditionally had higher recovery rates in the event of defaults.

UTILISATION RISK: The Trust invests in loans whose level of draw down may vary over time. Returns to the Trust will vary according to the level of utilisation by borrowers of such progress draw facilities.

QUALITATIVE DUE DILIGENCE

ORGANISATION

The Investment Manager is QRI Manager Pty Ltd, a wholly owned entity of the Qualitas Group (Qualitas). Qualitas was formed in 2008 as a specialist real estate investment management firm, focussed on investing across both equity and debt capital structures. Qualitas operates an integrated business where origination, asset due diligence, financial due diligence and credit risk are undertaken internally.

The business was co-founded by Group Managing Director and CIO, Andrew Schwartz and Global Head of Real Estate, Mark Fischer. Ownership is split 50% to Andrew Schwartz, and the remainder to interests associated with Alan and Carol Schwartz (note: not related to Andrew Schwartz).

Qualitas investment philosophy is to seek deep value-based opportunities across the entire capital structure, with a focus on risk mitigation and management. Qualitas' operations span both investment and loan management. Due to the nature of the asset class i.e. limited liquidity, Qualitas has traditionally focused on the institutional market, with the Trust representing their first foray into the retail market.

Qualitas undertakes their own distribution and currently operates a number of funds and direct investment mandates. Qualitas also owns Arch Finance, a major non-bank mortgage originator and lender to commercial borrowers.

Overall, Zenith considers Qualitas to be a well-structured and focused Australian lender. The historical focus on institutional and high net worth clients means that navigating retail market distribution is an aspect of the business which will require ongoing development. Zenith notes however that Qualitas is proactively addressing resources in this area.

Zenith notes that a wholly owned subsidiary of Qualitas holds 6.25 million units in the Trust. Under the conditions of the Investment Management Agreement (IMA), any units subscribed are to be held for the term of the IMA (five years). Zenith sees this as an important alignment of interests between Qualitas and investors in the Trust.

Qualitas currently manages approximately $A 2.5 billion firmwide (as at 31 March 2020). Assets Under Management (AUM) in Qualitas funds with dedicated mandates in which the Trust may invest is approximately $A 145.4 million.

As at 31 March 2020, the Trust had a market capitalisation of $A 293 million.

INVESTMENT PERSONNEL

Name	Title	Tenure
Andrew Schwartz	Group Managing Director & Co-Founder	10 Yr(s)
Mark Fischer	Global Head of Real Estate	11 Yr(s)
Rob McLellan	Deputy Chief Risk Officer	5 Mth(s)

Qualitas employs 53 staff across its offices in Melbourne and Sydney (excluding Arch). Qualitas' business structure operates across several key divisions, spanning Investment, Risk, Capital & Portfolio Management, Corporate Services and Operations (Strategy, Finance, Operations, PR, HR, IT).

Qualitas utilises multiple committees and boards to maintain oversight over operations and investment policies. Most directly relevant to investment and portfolio operations for the Trust are:

- Qualitas Group Advisory Board (AB): Group governance and oversight. Has six members and is majority independent, including an independent chair.
- Qualitas Group Risk Committee (RC): Monitors and reports to Advisory Board on enterprise risk management. Has four members and is majority independent, including an independent chair.
- Fund Investment Committees (IC): Responsible for transactional due diligence, approvals, ongoing monitoring and investment reporting. Chaired by the Chief Risk Officer. Each Qualitas fund has its own dedicated IC with specific members tailored to that vehicle (minimum three members and includes non-executive directors of Qualitas as voting members). Voting at all IC's must be unanimous.
- Portfolio Allocation Committees (PAC): Assessment of investment eligibility and capital deployment. Has four members and is chaired by the Head of Institutional Capital.
- Portfolio Asset Management Committee (PAMC): Monitors activities, progress and projections at the investment level for all assets under management. Each Qualitas fund has its own dedicated PAMC with specific members tailored to that vehicle. The Chief Risk Officer chairs all PAMCs and each includes non-executive directors of Qualitas as voting members.

Key staff listed in the table above comprise all internal members of the PAMC. Qualitas Non-Executive Directors, Michael Schoenfeld and David Krasnostein also sit on the PAM as external members. In addition, Schoenfeld acts as the Independent Chair of the AB. Each of the committees above (excluding the AB), have a high level of common representation from key senior Qualitas personnel. In particular, Andrew Schwartz (Group Managing Director), Tim Johansen (Global Head of Capital), Mark Fischer (Global Head of Real Estate) and Robert McLellan (Deputy Chief Risk Officer) have high participation across these committees as well as underlying operations.

The IC dedicated to the Trust comprises Andrew Schwartz, Michael Schoenfeld, David Krasnostein, Robert McLellan, Tim Johansen and Jason Rackley.

Operationally, the following teams are key drivers of the investment decision-making process with relevance to the Trust:

- Global Real Estate: Mark Fischer (Melbourne) leads a team of 18 which are responsible for origination and asset management of all lending opportunities as well as portfolio management of fund mandates across the Qualitas platform.
- Risk: Robert McLellan (Melbourne) leads a team of six which are responsible for managing transaction risks across the Group.

Zenith noted that in March 2019, Chief Risk Officer Gerd Mayer announced his intention to retire. In January 2020, Qualitas hired Robert McLellan as Deputy Chief Risk Officer to work alongside Mayer until his planned departure in July 2020. Zenith sees McLellan as a robust replacement for Mayer as he has spent the last 13 years with ANZ in a range of senior origination, execution and credit roles.

In 2019, Qualitas also undertook a reorganisation of the business structure. This involved consolidating its Real Estate Finance (debt investments), Principal Investments (equity investments) and Portfolio Management teams into a single Global Real Estate unit, headed by Fischer. Of particular note, Johansen moved from his role as Managing Director of Real Estate Finance, which was responsible for the origination and asset management of all Qualitas debt investments.

While Johansen's change in role is potentially a reduction in team strength for debt operations, we note that he remains part of the overall committee framework overseeing Qualitas' lending operations. In addition, other senior staff in the origination team remain unchanged, and as such we do not believe the reorganisation is materially detrimental.

Qualitas utilises team-based decision making processes to reduce key person risk and biases. As such, key person risk to the Trust is relatively low as the main operational functions tend to be dealt with by committees rather than individuals. This provides an element of redundancy protection to the system which Zenith sees as an advantage. While traditionally Zenith views investment managers with too many committee-based decision making processes as a potential impediment to efficiency and reducing nimbleness, given the nature of real estate lending as an asset class, we feel it is appropriate in this case.

Zenith believes that the level of depth and expertise held across the members of the committees and boards listed above, is significant and a key strength of the business. Zenith believes that the high levels of independent representation on the majority of these acts as a strong risk control.

Staff remuneration is predominantly based on fixed salaries, with discretionary bonuses determined each year in accordance with the company's financial performance. Zenith notes that remuneration for senior investment management staff is linked to fund performance via an allocation of performance fees.

INVESTMENT OBJECTIVE, PHILOSOPHY AND PROCESS

The Trust objective is to achieve an annual target return of 8.0% (net of fees and expenses), provide monthly cash income, capital preservation and portfolio diversification. The Trust, through its investment in the Sub-Fund, seeks to invest in a portfolio of investments that provide direct and indirect exposure to Australian and New Zealand secured real estate loans.

The Trust's portfolio gains exposure to private credit via indirect or direct exposure to loans secured by real estate assets. Indirect exposure is through investment in unlisted funds or other discretionary managed funds operated by Qualitas or its subsidiaries. Direct investments may also be made as necessary.

Qualitas adopt a fundamentally driven, bottom-up approach to investing, with opportunities assessed based on four key investment principals. These are also used as a risk management framework for investment management.

- Quantum of return: Seeking to accurately forecast returns and their components (loan interest, fees and capital)
- Timing of returns: Seeking to forecast the timing of cashflows with a reasonable degree of certainty
- Assessment of known risks: Seek to understand and mitigate risks where possible (as opposed to avoiding risks)
- Ability to exert influence over known risks: Ensuring deals are structured to mitigate risk

The Trust primarily focuses on gaining exposure to real estate lending which is secured by first ranking mortgages on Australian property. The Trust also gains limited exposure to loans which are subordinated (second ranking or mezzanine loans). Selective exposure to loans on New Zealand property will also be considered as appropriate although Zenith notes that as at the date of this report, no NZ exposure was held.

Target markets are commercial borrowers seeking to finance real estate development, investment, acquisition or value-add projects. Sectors involved are mainly residential (apartments and other multi-dwelling buildings), office, retail and industrial.

SECURITY SELECTION

The Trust is relatively unconstrained in its ability to invest in senior secured real estate loans, either directly or indirectly through investment in unlisted funds with similar mandates. Unlike a traditional multi-manager offering, the Trust is structured to invest in Qualitas' vehicles or that of its subsidiaries where possible. As such, Qualitas focuses on investing within its own funds and mandates, taking exposure when it is consistent with the Funds investment objectives. Accordingly, the more traditional type of manager selection process is not evident in the Fund as with traditional multi-manager strategies.

Fund Selection

The Trust is currently expected to have exposure to four main vehicles, each with varying investment objectives and return targets.

- Qualitas Senior Debt Fund (QSDF): Open-ended fund with a return target of 4.0% to 6.0% over the 90-day BBSW (Bank Bill Swap Rate), net of fund expenses and management fees. Senior secured loans only.
- Qualitas Mezzanine Debt Fund (QMF): Closed-ended Fund with an annual series issued. Return target of 11.5% IRR (net of all fees). Second-ranking loans only.
- Qualitas Land Debt Fund (LDF): Closed-ended fund with a return target of 9.5% to 10.5% IRR (net of all fees). Senior secured loans on land only.
- Arch Finance Warehouse Trust (Arch): Closed Ended warehouse funding arrangement structured as securitised notes. While Arch only finances senior secured loans, the securitised structure subordinates investor holdings depending on the tranche of note held. Interest rates in the tranches which the Trust may utilise currently have a weighted average return of 7% p.a.
- Direct Loans: Loan term, return and parameters will vary on a case by case basis. However, all loans must be either first or second mortgage.

Given the construct of the Trust as a fund of funds strategy, Zenith would ideally prefer to see greater rigour around investment selection protocols in choosing funds in through which to deploy Trust capital, particularly as other fund exposures may be added in the future.

Zenith notes that while Arch is a wholly owned subsidiary of Qualitas, the business essentially operates as an independent entity. Arch has its own personnel, lending criteria and risk management processes. As such, it should be noted that the following loan selection process relates to Qualitas, not Arch.

Loan Selection

The lending process involves fundamental, bottom-up project and credit analysis which is detailed in an investment submission, forming the basis for all investment decisions. Qualitas' deal selection process has five stages before a bid is launched.

Origination

Deal sourcing utilises both internal origination and third-party sources. While Qualitas prefers to use direct relationships to originate deals, given the size of the business, one third of deals come from external sources. Regardless of origin, Qualitas undertake their own full due diligence process on all deals.

The Global Real Estate team hold weekly origination meetings to discuss new deal sourcing and potential investment fit. A senior member of the origination team will typically conduct a high-level review to determine if formal initial due diligence should be launched. A separate meeting is held to monitor the progression of deals which have been approved for formal due diligence.

The Risk team, led by McLellan, will also undertake a preliminary review of the proposal. The Risk team has input at each point of the selection and approvals process, ensuring deals which fail to meet risk criteria do not proceed too far through the due diligence process.

Initial Evaluation

Deals passed from origination undergo a preliminary review to establish if they warrant serious consideration. If this analysis is positive, senior management will discuss and provide the approval to proceed as necessary.

Heads Up Paper

Paper submitted to the relevant IC for approval of support and provision of any relevant feedback. Successful applications added to the deal pipeline, which included the commencement of reporting.

Detailed Due Diligence

Once deals are considered appropriate for formal consideration, Qualitas will seek a mandate from the borrower and an indicative term sheet issued, formal due diligence is entered into. Due diligence covers multiple aspects, relating to the borrower, the transaction structure, transactional third parties (builders, tenants, operators etc), the property being used as security and the market. All transactions are modelled to test assumptions, forecast returns and to create sensitivities. Key assumptions for transactions are validated and tested by internal and external reference points.

Results are documented in a formal credit risk paper. This paper is considered by the risk department prior to being submitted to the IC for approval.

Formal Investment Committee Approval

On receiving a submission, the IC will meet to consider the proposal and decline or approve, including any specific conditions. Approval from the PAC is also sought.

Once a loan is structured and funded, there are two additional steps in the process.

Asset Management

Once funded, the status of each loan and the underlying property performance undergoes continuous monitoring. Formal reporting to the PAMC occurs at least every six to eight weeks. Project monitoring encompasses issues such as reviewing project budgets, costs to complete, progress reporting, sales rates and date of practical completion. As part of the process, monitoring will also encompass market conditions, site visits, ongoing project valuations, development approvals and project milestones.

Monitoring of loan covenants and development of sensitivity analysis throughout a projects life is an integral part of Qualitas' process. In particular, property income, valuations, cashflow forecasts, project profitability and settlement defaults are monitored closely.

Exits

Exits are generally made in accordance with the investment thesis. During the due diligence and loan monitoring process, alternative exit avenues are considered as a contingency.

Overall, Zenith is impressed with the rigour of the processes around due diligence and ongoing monitoring of loans. Project development finance, which forms a material part of Qualitas' lending operations, is a specialised business. Zenith has reviewed a range of supporting documentation forming each step on the origination, approval and monitoring process and found them to be detailed and of high quality. In particular, post-investment analytics, including an understanding of exit strategies in both normal circumstances and in the case of a distressed borrower/project, is a strong point.

Given that Qualitas as a business operates across the full spectrum of credit quality, Zenith believes this is a competitive advantage in lending operations.

PORTFOLIO CONSTRUCTION

The Trust seeks to invest in a portfolio of investments with direct and indirect exposure to loans. The Trust is expected to have exposure to five main vehicles, each with varying investment objectives and return targets.

- Qualitas Senior Debt Fund (QSDF)
- Qualitas Mezzanine Debt Fund (QMF)
- Qualitas Land Debt Fund (LDF)
- Arch Finance Warehouse Trust (Arch)
- Direct Loans:

It should be noted that the Trust may take exposure to other funds with varying terms at Qualitas discretion. The Trust target portfolio is 60% to 75% in Qualitas funds and Arch (Arch being limited to 15%) and 25% to 40% in direct loans.

Key considerations regarding portfolio allocations include:

- impact of the investment on the Trust's portfolio returns;
- impact of the investment on the Trust's portfolio key metrics;
- maturity of the debt;
- availability of capital to fund an investment opportunity;
- alignment of the investment opportunity with the economic outlook; and
- whether the investment is consistent with the Trust's investment strategy.

Qualitas operates an Allocation Policy which governs allocations of investments across its funds. All Qualitas funds which have a similar mandate to the Trust have an equal priority to invest in secured real estate loan opportunities, subject to individual investment mandates and portfolio constraints. If a loan opportunity is allocated in part to another Qualitas fund, the remainder will be offered to the Trust.

Zenith notes that Qualitas may selectively engage in lending operations in New Zealand. While Qualitas continues to apply their rigorous lending and monitoring standards offshore, Zenith believes that these deals will nonetheless carry an elevated risk profile. Zenith's view is that lending operations are best carried out where the lender has a local presence, given that local knowledge is vital and monitoring progress will be more problematic.

Zenith also notes that the Trust may use operational leverage to manage capital flows, up to 10% of the Trust's NAV. Given that the Trust is essentially a closed-end structure in relation to capital availability, Zenith considers this to be appropriate. However, there is a risk element with any form of leverage.

Ideally, Zenith would prefer to see greater rigour regarding the framework for blending of portfolios between funds and direct loans. In particular, we believe that there should be a clear distinction and allocation guidance between proposed investment between QSDF and Arch. While both are investing in senior secured real estate loans, the risk and return profile between the two exposures is materially different owing to the effect of subordination in the Arch notes. Zenith notes that Qualitas have set an internal exposure to Arch of no more than 15% of the portfolio.

RISK MANAGEMENT

Portfolio Constraints	Description
Capital exposure to any single fund (Ex-Arch)	Maximum 40%
Exposure to Arch Finance Warehouse Trust	Max 15%
Mezzanine Loans	Max. 35%
Regional diversification (portfolio lookthrough)	Less than 30% exposure to non-capital cities in Australia/NZ
Max. Exposure to NZ Loans	20%
Cash	Max. 100%

Qualitas' risk management processes for the Trust are centred on the analysis of lending risk and return expectations. Risk budgets are principally derived from those placed on the underlying funds and mandates, rather than that of the Trust itself.

The Trust's formal investment constraints within mortgage lending, are minimal. Although the Trust has minimal risk constraints, the underlying funds in which Qualitas will seek to deploy initial capital do possess detailed risk constraints. At a high level, these risk constraints include the following:

Investment Guidelines	QSDF	QMF	Arch
Loan Type	Investment, Construction, Other	Construction	Investment
Security Type	Senior Loan	Mezzanine Loan	Senior Loan
Portfolio Size	Portfolio >$50m	Portfolio <$50m	
VIC	75%	100%	100%
NSW	75%	100%	100%
QLD	40%	50%	25%
WA	40%	40%	10%
SA	20%	20%	10%
ACT/NT/TAS	15%	40%	13%
Max. Sector			
Industrial	50%	50%	50%
Commercial	50%	50%	50%
Retail	50%	50%	50%
Residential	100%	100%	30%
Specialist	15%	15%	-
Vacant Land	-	0%	-
Max. Capitaising Loans	10%	-	-
Max. Single Borrower	15%	N/A	$A 7.5m
Max. Loan Size	-	-	$A 5m
Max. Loan Term	60 mths	60 mths	Max. 10% with term > 3 yrs & < 5 yrs for IO loans. Max . 15% to have > 5 yr P&I loans
Max. LVR/LTC Covenants			
Investment Loans	75% LVR	80%	65% to 75% LVR, limited to 5% of portfolio
Construction Loans	85% LTC	80%	-
Other Loans	75% LVR	80%	-
Minimum Debt Servicing Ratio			>1.5x

Trust performance and risk profiles are monitored on an ongoing basis. Overall, Zenith believes that risk management occurs more through the constant oversight provided by the portfolio manager rather than through formal tools and constraints.

In addition to formal risk constraints, Qualitas believes risk is managed throughout the entire investment process.

Zenith notes that the underlying Qualitas funds operate as unregistered managed investment schemes. These schemes are operated by a Trustee (a Qualitas entity) rather than an independent Responsible Entity. Unregistered schemes operated by Trustees do not typically have the same level of mandatory strictures, compliance and external oversight as do registered schemes. As such, Zenith intrinsically sees such operations as a potentially higher risk to investors from a legal and compliance perspective. Zenith would prefer to see the Qualitas transition to using registered scheme structures in its funds, although we acknowledge that this is not legally required.

Zenith believes that risk management in the underlying funds and exposures is rigorously managed. While acknowledging that formalised risk constraints have increased, we would prefer to see more formal risk constraints around exposures constraints for senior loans (set internally at 65% to 80%).

All internal targets / weightings are reviewed on an ongoing basis with reference to market conditions and opportunities.

Environmental, Social & Governance (ESG)

While the Trust does not have any specific ESG investment exclusions in the traditional sense, Qualitas may utilise ESG factors as part of their own investment processes.

INVESTMENT FEES

ICs can broadly be categorised into two groups from a management and fee standpoint on the basis of whether they are internally or externally managed (operating under an individually managed account). Typically, internally managed LICs have lower proportional management costs due to a larger asset pool. Externally managed LICs tend to have management costs more in-line with unlisted managed funds.

The Trust is subject to annual management costs to Qualitas of between 1.86% – 2.16% p.a. inclusive of GST, which comprises the following:

- Management fees: 1.5375% p.a. of Trust NAV
- Responsible Entity fee: 0.03% to 0.05%
- Recoverable expenses: Estimated at 0.29% to 0.56% p.a.

Based on the NAV of the Trust as at 31 March 2020, the aggregate management cost is 1.95% p.a.

Zenith notes that Qualitas applied a management fee discount to the Trust during a capital raise conducted in September 2019. The management fee reduces by 50% with respect to the proportion of NAV of the Trust that reflects the capital raised that is yet to be invested in qualifying assets. As at 31 March 2020, invested capital was approximately 86%.

The Trust may also be subject to Loan Origination Fee for direct loans where the Trust is the sole lender. These fees will be 33% of the applicable loan fees to a borrower. Where the Trust is a co-lender, this percentage will be determined between the applicable co-lenders.

There is also a performance fee which is eligible once a cumulative target return of 8.0% p.a. (net of fees and expenses) is reached. This fee operates under a profit share between the Trust and Qualitas and is accrued monthly and paid annually in arrears. The performance structure is as follows:

- Trust will distribute income equal to the cumulative target return of 8.0% p.a.
- Any income above an 8% p.a. target return hurdle is shared between the Trust (80%) and Qualitas (20%).

The calculation for the performance fee commenced on 1 July 2019 and every three years thereafter. For the purposes of calculation, the cumulative target return is also resettable every three years.

For the term of the IMA, the Trust will not incur any management or performance fees arising from the underlying funds or mandates in which it invests.

While the Trust has not yet generated a sufficient performance record to determine whether or not investors are sufficiently compensated by the fee structure, overall, Zenith considers the Trust to be expensive. Although supportive of netting off fees on underlying funds from the same manager and while taking into consideration the high return target, Zenith believes that the overall management cost is excessive.

Zenith notes that Qualitas have utilised a loan to meet listing costs. The loan has been made on an arms-length basis between the Fund and Qualitas and is for a ten-year term from the date of the most recent draw down under each new tranche of capital raised. The loan is interest bearing at a commercial rate with all income accruing to the benefit of the Trust. Zenith sees this as a positive feature to offset the upfront expense of issue costs that would otherwise result in an immediate dilution to NTA.

Investment Fees		
Product		Qualitas Real Estate Income Fund
Asset Class		Australian Fixed Interest
Sub-Asset Class		Aust. Fixed Interest - Specialist
Management Structure		Externally Managed
Management Cost		1.95%
Performance Fee		20% profit share triggered over a 8.0% p.a. performance hurdle
Annual Management Fee Comparision		**% p.a.**
Australian Fixed Interest	Peer Average - LICs/LITs (Internally Managed) [1]	N/A
	Peer Average - LICs/LITs (Externally Managed)	1.24%

[1] *Internally Managed LICs/LITs data use published Management Cost as a percentage of assets. All other vehicles quote management fees and costs inclusive of GST, less Reduced Input Tax Credits where available.*

PERFORMANCE ANALYSIS

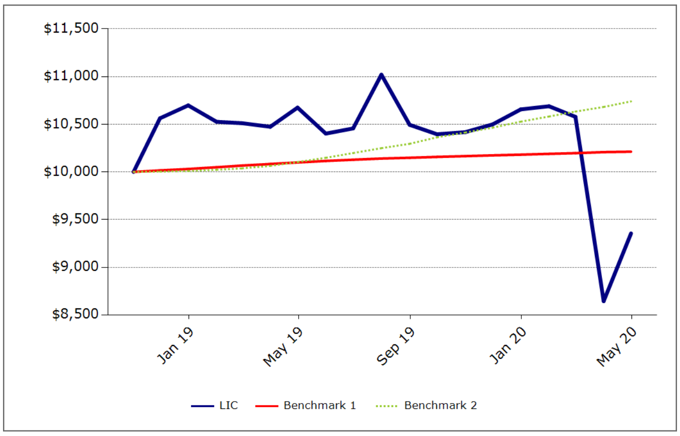
Report data: 30 Apr 2020, product inception: Nov 2018

Monthly Performance History (%, net of fees)

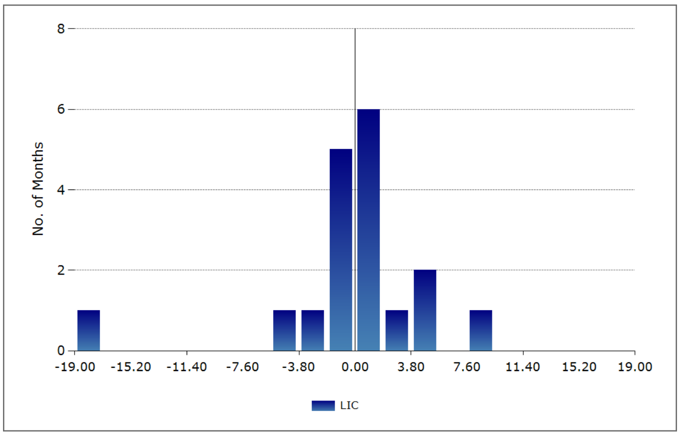
	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	LIC YTD	BM1 YTD	BM2 YTD
2020	0.31	-1.04	-18.28	8.22									-12.21	0.30	2.02
2019	-1.60	-0.14	-0.36	1.92	-2.55	0.52	5.39	-4.77	-0.94	0.21	0.78	1.50	-0.39	1.50	5.16
2018											5.63	1.28	6.98	0.31	0.10

Benchmark 1: Bloomberg AusBond Bank Bill Index, Benchmark 2: QRI Net Portfolio Returns

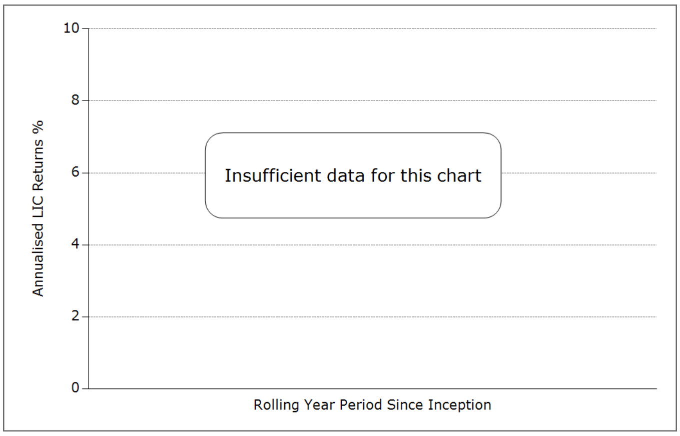
Growth of $10,000



Monthly Histogram



Minimum and Maximum Returns (% p.a.)



ABSOLUTE PERFORMANCE ANALYSIS

Return	Incpt.	1 yr	6 mth	3 mth
LIC (% p.a.)	-4.35	-12.36	-10.20	-12.48
Benchmark 1 (% p.a.)	1.41	1.12	0.46	0.22
Benchmark 2 (% p.a.)	4.87	6.29	3.14	1.50
Median (% p.a.)	-5.22	-12.05	-15.06	-16.36
Ranking within Sector	**Incpt.**	**1 yr**	**6 mth**	**3 mth**
Fund Ranking	2 / 4	3 / 4	2 / 5	2 / 5
Quartile	2nd	3rd	1st	1st
Standard Deviation	**Incpt.**	**1 yr**	**6 mth**	**3 mth**
LIC (% p.a.)	18.33	21.35	28.06	38.03
Benchmark 1 (% p.a.)	0.14	0.10	0.05	0.07
Median (% p.a.)	13.19	18.60	27.57	38.03
Downside Deviation	**Incpt.**	**1 yr**	**6 mth**	**3 mth**
LIC (% p.a.)	14.59	17.38	23.37	29.04
Benchmark 1 (% p.a.)	0.00	0.00	0.00	0.00
Median (% p.a.)	11.77	15.03	21.18	25.46
Risk/Return	**Incpt.**	**1 yr**	**6 mth**	**3 mth**
Sharpe Ratio - LIC	-0.31	-0.63	-0.38	-0.33
Sortino Ratio - LIC	-0.39	-0.78	-0.46	-0.44

Readers should note that unless otherwise indicated, all performance, consistency and risk/return data is referenced to the Zenith assigned benchmark (as represented by Benchmark 1 in the above table) with the LIC returns representing those attributable to shareholders (i.e. unit price + distributions). For comparison purposes, Zenith has also included the net returns of the investment portfolio (as represented by Benchmark 2 in the above table) as Zenith believes this is the best measure of the investment managers skill. However, investors should note that whilst we expect the portfolio returns to be a key driver of the unit price over the longer-term, due to the LIT structure, these returns may not be able to be fully realised by unitholders at various points in time.

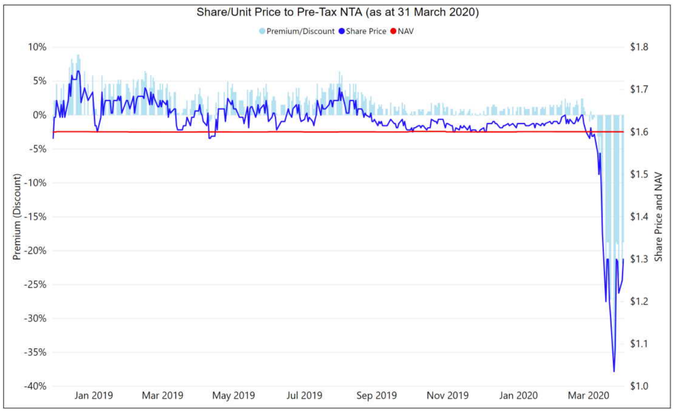
All commentary below is as at 31 March 2020.

The Trust objective is to achieve an annual target return of 8.0% (net of fees and expenses), provide monthly cash income, capital preservation and portfolio diversification.

The Trust currently has insufficient performance history to provide meaningful analysis. However, Qualitas' has demonstrated a prior ability to generate returns from real estate financing in-line with the stated objective of this Fund, providing Zenith with some confidence that the internal performance target may be met.

Share Price vs. NTA

The following chart shows the Trust's premium/discount since inception.



WARNING: Zenith ratings applied to LITs do not explicitly take into account unit prices vs. NAV and do not represent a buy/sell recommendation based on a LITs valuation. Potential investors should make their own determination of the appropriateness of prevailing premiums or discounts to NAV when acquiring or disposing of a LIT.

RELATIVE PERFORMANCE ANALYSIS

Alpha Statistics	Incpt.	1 yr	6 mth	3 mth
Excess Return (% p.a.)	-5.76	-13.48	-10.66	-12.70
% Monthly Excess (All Mkts)	55.56	58.33	66.67	33.33
% Monthly Excess (Up Mkts)	55.56	58.33	66.67	33.33
Beta Statistics	**Incpt.**	**1 yr**	**6 mth**	**3 mth**
Beta	0.94	-50.20	-455.71	-505.72
R-Squared	0.00	0.05	0.76	0.95
Tracking Error (% p.a.)	18.33	21.37	28.10	38.11
Correlation	0.01	-0.22	-0.87	-0.98
Risk/Return	**Incpt.**	**1 yr**	**6 mth**	**3 mth**
Information Ratio	-0.31	-0.63	-0.38	-0.33

All commentary below is as at 31 March 2020.

It is important to note that the Relative Performance Analysis shown above combines the LITs unit price returns with dividends to give the reader detail on the investor experience.

Zenith seeks to identify funds that can achieve an outperformance ratio above 50% of months in all market conditions as we believe this represents a persistence of manager skill.

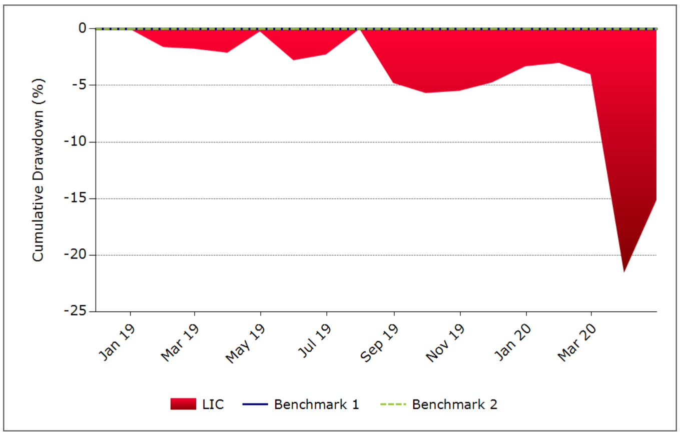
The Trust currently has insufficient performance history to provide meaningful analysis.

DRAWDOWN ANALYSIS

Drawdown analysis assesses the relative riskiness of a Fund versus the benchmark, in reference to capital preservation. The maximum Drawdown is recorded as the percentage decline in the value of a portfolio from peak to trough (before a new peak is achieved). All Drawdown analysis is calculated commencing from the inception date of the Fund in question, and Drawdown analysis for the Fund and benchmark(s) are calculated independently. That is, the largest drawdown for the Fund and benchmark(s) will not always refer to the same time period.

Drawdown Analysis	LIC	BM1	BM2
Max Drawdown (%)	-21.56		
Months in Max Drawdown	8		
Months to Recover	-		

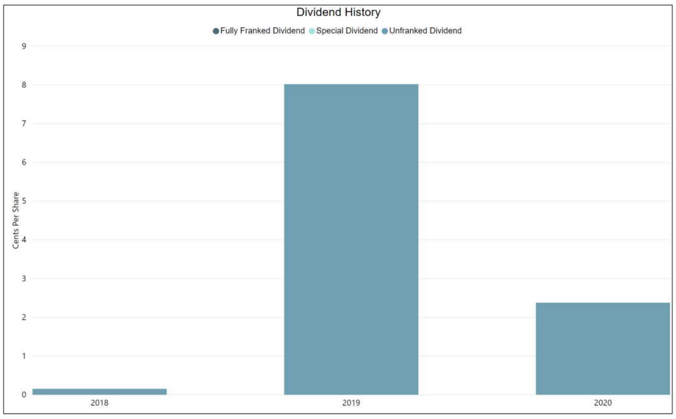
Worst Drawdowns	LIC	Benchmark 1	Benchmark 2
1	-21.56		
2	-2.77		
3			
4			
5			



All commentary below is as at 31 March 2020.

The Trust currently has insufficient performance history to provide meaningful analysis.

Investors should be aware that accessing a strategy via a LIT will mean that the effectiveness of the strategy may be significantly diminished due to the Fund's own trading movements. That is, investors may not be able to benefit from the portfolio's performance, as the performance of the Fund is driven by market sentiment.



DISTRIBUTION POLICY

The Trust will aim to pay monthly distributions, with the current target return of 8.0% p.a. (net of fees and expenses).

As at 31 March 2020, the Trust's Distribution Reinvestment Plan (DRP) is currently suspended.

REPORT CERTIFICATION

Date of issue: 2 Jun 2020

Role	Analyst	Title
Author	Dugald Higgins	Head of Real Assets & Listed Strategies
Sector Lead	Dugald Higgins	Head of Real Assets & Listed Strategies
Authoriser	Bronwen Moncrieff	Head of Research

ASSOCIATIONS & RELATIONSHIPS

ASIC Regulatory Guide RG79.164 requires Research Houses to disclose certain associations or relationships that they may have with a product issuer. As at the date this report was issued, an associated entity of either the Issuer or Investment Manager relevant to this report is; or has been, a subscriber to Zenith's investment research services within the past 12 months. Conflict management arrangements are in place where Zenith provides research services to financial advisory businesses who provide financial planning services to investors and are also associated entities of product issuers. This is in accordance with Zenith's Conflict of Interests Policy.

RATING HISTORY

As At	Rating
2 Jun 2020	Approved
23 May 2019	Approved
11 Oct 2018	Not Rated - Screened Out

Last 5 years only displayed. Longer histories available on request.

DISCLAIMER AND DISCLOSURE

Zenith Investment Partners (ABN 27 103 132 672) is the holder of Australian Financial Services Licence 226872 and is authorised to provide general financial product advice. This Product Assessment Report (report) has been prepared by Zenith exclusively for Zenith clients and should not be relied on by any other person. Any advice or rating contained in this report is limited to General Advice for Wholesale clients only, based solely on the assessment of the investment merits of the financial product. This report is current as at the date of issue until it is updated, replaced or withdrawn and is subject to change at any time without notice in line with Zenith's regulatory guidelines. Zenith clients are advised to check the currency of reports and ratings via Zenith's website for updates and should also verify information in relation to the fund with the relevant Fund Manager. Any advice contained in this report has been prepared without taking into account the objectives, financial situation or needs of any specific person who may read it. It is not a specific recommendation to purchase, sell or hold the relevant product(s). Investors should seek their own independent financial advice, obtain a copy of, and consider any relevant PDS or offer document and consider the appropriateness of this advice in light of their own objectives prior to making any investment decision. Zenith charges an upfront flat fee to the Product Issuer, Fund Manager or other related party to produce research on funds that conform to Zeniths Research Methodology. Zenith's fee and Analyst remuneration are not linked to the rating outcome in any way. Views expressed in Zenith reports accurately reflect the personal, professional, reasonable opinion of the Analyst who has prepared the report. Zenith may also receive a fee for other non-research related services such as subscription fees for Zenith's research services and/or for the provision of investment consultancy services. Conflicts management arrangements are in place where Zenith provides research services to financial advisory businesses who provide financial planning services to investors and are also associated entities of the product issuers, with any such conflicts of interest disclosed within reports as appropriate. Full details regarding such arrangements are outlined in Zenith's Conflicts of Interest Policy
www.zenithpartners.com.au/ConflictsOfInterestPolicy

Zenith's research process seeks to identify investment managers considered to be the 'best of breed' through a comprehensive, multi-dimensional selection process. Zenith utilises both quantitative and qualitative factors in its ratings models. Models maximise commonality across different asset classes while retaining flexibility for specialist asset classes and strategies. The selection process is rigorous in both its qualitative and quantitative analysis and each component is equally weighted. Zenith does not manage any proprietary assets and as such Zenith is able to choose investment managers with absolute independence and objectivity. More detailed information regarding Zenith's research process, coverage and ratings is available on Zenith's website
www.zenithpartners.com.au/ResearchMethodology

 The information contained in this report has been prepared in good faith and is believed to be reliable at the time it was prepared, however, no representation, warranty or undertaking is given or made in relation to the accuracy or completeness of the information presented in this report. Except for any liability which cannot be excluded, Zenith does not accept any liability, whether direct or indirect arising from the use of information contained in this report. Past performance is not an indication of future performance.

Full details regarding the methodology, ratings definitions and regulatory compliance are available at
www.zenithpartners.com.au/RegulatoryGuidelines

Zenith has charged QRI Manager Pty Ltd a fee to produce this report.